No. 12961

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, etc., *et al.*,
Appellant and Respondent,

vs.

CERTAIN PARCELS OF LAND IN THE CITY OF LOS ANGELES, COUNTY OF LOS ANGELES, STATE OF CALIFORNIA, *et al.*,
Defendants,

and

RECONSTRUCTION FINANCE CORPORATION, Assignee of TREASURE COMPANY, THE ADAMANT COMPANY, WALTER B. SCOVILLE, JOE SEEPLE, HARRY WYNN, HERSCHEL BULLEN, MARY N. BULLEN, J. C. HAYWARD and MARY S. HAYWARD,
Respondents and Cross-Appellants.

Upon Appeal From the United States District Court, Southern District of California, Central Division.

Brief for Reconstruction Finance Corporation, Assignee of Treasure Company, Respondent.

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Respondents and Cross-Appellants.

Brief for Reconstruction Finance Corporation, Assignee of Treasure Company, Respondent.

As pointed out in the statement of the case incorporated in the brief heretofore filed by Reconstruction Finance Corporation (hereinafter in this brief called "RFC"), as appellant, this is a case where all parties-distributee, including RFC, as assignee of Treasure Company, have taken an appeal from the judgment of distribution entered by the Honorable Harry C. Westover on October 30, 1950.

This brief which RFC files in its capacity as a respondent discusses the several contentions in the opening appellants' briefs filed by the appellants, The Adamant Company, Walter B. Scoville, Joe Seeple and Harry

Wynn, and by the appellants, Herschel Bullen, Mary H. Bullen, J. C. Hayward and Mary S. Hayward. The latter appellants, whose interests are identical, are hereinafter in this brief called the "Haywards." Insofar as possible, the arguments of the appellants have been treated seriatim.

There Is No Merit to the Contention That the "Haywards" Are Entitled to Distribution Under the "Two for One" Agreement Out of the Share of the Award Now Assigned to RFC.

The District Court held that Treasure Company did not execute the "two for one" agreement and is not bound thereby [Fdg. XXV, R. 146] and that the enforcement of this agreement is a personal matter between the "Haywards" and Scoville [Concl. VII, R. 152].

The "Haywards" allege error in the District Court's holding with respect to the "two for one" agreement and cite the case of *Recovery Oil Co. v. Van Acker,* which was before the District Court of Appeal on two occasions as reported in 79 Cal. App. 2d 639, 180 P. 2d 436 (1947), and in 96 Cal. App. 2d 909, 216 P. 2d 483 (1950). They assert that the *Van Acker* case is "on all fours" with the case at bar and that under its holding the "two for one" agreement is a royalty interest and therefore an interest in the land. On this premise the "Haywards" argue that they held a vested interest in the leasehold which was to have continued until they received payment in full, and that having received no payment their interest is transferred to the award which stands in place of the leasehold.

RFC concedes that if Treasure Company is bound by the "two for one" agreement, RFC's rights, as assignee of Treasure Company's interest in the award, are con-

trolled by the *Van Acker* case. However, the case is not "on all fours" with the case at bar even though the similarity of *some* of the facts presents one of those duplications of circumstance in which all lawyers delight.

In the *Van Acker* case the District Court of Appeal recognized the property interest of one Ada M. Crawford in an oil and gas leasehold estate because she was able to prove that a right to share the proceeds from a certain percentage of oil production up to a fixed dollar amount had vested in her through various assignments, as against an original obligor, the lessee, and against the successor to the lessee's interest who had taken with constructive notice of her chain of title. Thus, the case stands for the proposition that the agreement of the lessee of an oil and gas lease to share the proceeds of a percentage of his oil production creates a royalty interest which, under California law, is an interest in real property.

The clear cut distinction between the *Van Acker* case and the case at bar lies in the fact that the obligation to pay a percentage of the oil proceeds was, in the *Van Acker* case, the obligation of the original holder of a prospecting permit (whose property interest matured into a leasehold estate) whereas, in the case at bar the obligation to pay "two for one" was an obligation created not by the original lessee, Treasure Company, but by Scoville, to whom it had assigned a fractional interest in the oil production.

The assignee, Scoville, could reassign what he owned but could create no new royalty or vested interest in the leasehold of Treasure Company by agreement with third parties unless the lessee, Treasure Company, itself were bound by the agreement.

The question therefore is: Was Treasure Company, the original lessee, bound by the "two for one" agreement?

The "Haywards" in asserting that Treasure Company is bound by the "two for one" agreement urge the following points:

1. Treasure Company consented to an application filed with the Corporation Commissioner of California requesting the Commissioner's consent to the transfer in escrow to them of two 1% participating royalty interests from Scoville;

2. The application to the Corporation Commissioner recites the "two for one" agreement and Treasure Company therefore had knowledge of this agreement;

3. The funds advanced by the "Haywards" were transferred by bankers' cashier's checks which show in the respective chains of endorsement the following: "Treasure Company Trust Fund by G. de Bretteville, Trustee"; and

4. The funds so advanced were accepted by Treasure Company with knowledge of the terms upon which they were advanced and the money was used by Treasure Company for its own benefit so that Treasure Company is estopped to deny that it was a party to the agreement.

In support of the District Court's holding that Treasure Company is not bound by the "two for one" agreement, it is possible to make a lengthy argument to the effect that the consent of Treasure Company to the transfer in escrow with the Corporation Commissioner was merely an act of accommodation to facilitate the transfer and in no wise an agreement with the "Haywards"; that the knowledge of Treasure Company to the terms

upon which Scoville obtained funds from the "Haywards" creates no legal commitment on the part of Treasure Company; that the deposit of such funds into the "Treasure Company Trust Fund" was in accordance with the agreement between Treasure Company, The Adamant Company and Scoville [Adamant-Scoville-Wynn, Ex. "D," R. 202, 1272]; and that Treasure Company's use of such funds was predicated on its understanding that they were appropriated to the development of the leasehold by Scoville and/or by The Adamant Company, the stock of which was owned by Scoville's wife, Helen Scoville [R. 1242].

A lengthy argument is unnecessary because none of the testimony introduced by the "Haywards," which appears in the printed record [R. 1188-1244], supports the claim now asserted. On the contrary, such testimony supports the conclusion that whereas the president of Treasure Company refused to assume responsibility for the "two for one" agreement [R. 1208] the obligation was admitted by Scoville to be his responsibility [R. 1209].

The issue of Treasure Company's liability on the agreement is conclusively resolved by evidence which the "Haywards" themselves have introduced and in the light of this evidence it is difficult to understand the position which they have assumed in their opening brief.

A letter dated August 22, 1939, addressed to the president of Treasure Company by one of the "Haywards" (the appellant, J. C. Hayward) was introduced as "Petitioners Bullen and Haywards' Exhibit No. 5" [R. 1212].

This letter clearly admits that the "two for one" agreement was personal between them and Scoville. It states in part:

> "I am enclosing herewith our instructions to Mr. Geo. Halverson agreed to by Walter B. Scovell and Walter B. Scovell Company, under date of September 27, 1938 in which *Mr. Scovell agrees to pay* to Herschel Bullen and the undersigned 15% of gross production from the well until the $5,000.00 is paid back two for one. We regard this as your authority if you are still operating the well *to deduct from Mr. Scovell's account* each month the equivalent of 15% of gross production and divide it between Mr. Bullen and myself.
>
> "This in no way makes you responsible to Mr. Scovell or the Scovell Company *as it was Mr. Scovell's suggestion and guarantee that we receive 15% of gross production from the well.*" (Emphasis added.)

The letter dated January 4, 1940, addressed to Charles S. Gass, Esq., who was then counsel for Treasure Company, by one of the "Haywards" (the appellant, J. C. Hayward) was introduced as "Petitioners Bullen and Haywards' Exhibit No. 6" [R. 1214]. This letter is even more pertinent and contains the following statements:

> "It is our contention now and has been all the way through that if Mr. Scoville guaranteed all of the money necessary to complete the well, then Mr. Scoville's royalties should be diverted from him to pay the debts which were incurred and our small interest should come to us and not be used as they have been.

"Mr. Bullen and myself could both see this thing through to its present status and we have advised Mr. Scoville on many occasions to attempt a settlement out of court. He could not see his way clear to do this and as a consequence *it is going to be necessary for us to take any action necessary to recover our money from him. We have never looked to anyone else for our money though he has tried to put over the idea that it was the responsibility of the entire group. We have notified him in writing and in conference that we were looking to him and to no one else to fulfill the terms of our contracts.*" (Emphasis added.)

These admissions are such that all efforts to erect a legalistic scaffolding of estoppel on which liability of Treasure Company on the "two for one" agreement can be established must fail. Section 1589 of the California Civil Code, which the "Haywards" cite, is not material for such scaffolding. The Supreme Court of California has held that this section applies only when the person accepting the benefit of the transaction is himself a party to the transaction: *Canale et al. v. Copello,* 137 Cal. 22, 69 Pac. 698 (1902); 6 Cal. Jur. 60.

It follows that inasmuch as Treasure Company, the original lessee, is not liable on the "two for one" agreement between the "Haywards" and Scoville, the agreement creates no royalty interest which is an interest in the leasehold estate, and the "Haywards" must perforce now do what they have admitted they always did—look to their recovery on the "two for one" agreement from parties other than the lessee or its successor in interest.

There Is No Merit to the Contention That the Holders of Participating Royalty Interests in Treasure Well Have an Equitable Lien Upon the Lessee's Interest in the Condemnation Award to Secure Payment to Them of Their Share of the Net Proceeds From the Operation of the Treasure Well Prior to the Government's Seizure.

Paragraph IV of the District Court's judgment denied an equitable lien upon the jury award to all of the several claimants who had demanded such a lien [R. 156].

The appellants, The Adamant Company, Scoville, Seeple, and Wynn allege error in the denial to them of an equitable lien on the share of the award now assigned to RFC to secure payment to them of $89,563.99 which they claim was owed to them by Treasure Company prior to the seizure date. They achieve this particular arithmetic by taking the sum of $205,411.68, which was stipulated to have been substantially the sum of money handled by Treasure Company as the gross proceeds of Treasure Well's production from the date of its completion on December 8, 1938, to the date of its seizure on September 28, 1942 [R. 1236]; by computing 47% of this sum (the aggregate of The Adamant Company's 25% claim, Scoville's 16% remaining claim, and Wynn's 6% claim) to be the sum of $96,543.49; by deducting therefrom $6,979.50 as "a sufficient operating charge" and thus arriving at a net balance of $89,563.99.

This ambitious computation deserves little consideration from this Court for the following reasons:

1. The stipulation on gross proceeds was "before the payment" of landlord's royalties [R. 1236], stipulated to have been 19.4% of the total production [R. 746].

2. No part of such gross proceeds handled by Treasure Company was owed to The Adamant Company, Scoville or Seeple for the period from December 8, 1938, to and including December 31, 1939 (for which there was an accounting) because of the express holding in paragraph II of the Vickers' Judgment [Adamant, Scoville, Wynn Ex. "E," R. 202, 1273].

3. Any portion of such gross proceeds handled by Treasure Company from January 1, 1940, to the date of seizure which may be owed to The Adamant Company, Scoville, and their assigns, is subject to a surcharge for their respective pro rata shares in the completion, operating and maintenance costs and charges of Treasure Well because of the express holding in paragraph III of the Vickers' Judgment, *supra.*

4. The completion, operating and maintenance costs and charges of Treasure Well to the date of its seizure are ascertainable and should not be arbitrarily estimated at $6,979.50 on the basis of testimony of experts in the evaluation trial, which testimony was addressed solely to *prospective* operating expense such as would have been incurred during the future economic life of the well without reference to costs and charges *actually incurred* prior to the date of seizure.

5. A separate accounting action against Treasure Company of which the District Court took notice [Fdg. XXXVII (misprinted XXXVI), R. 150] has been brought by The Adamant Company and Scoville and is presently pending before the Honorable Pierson M. Hall, Judge of the United States District Court for the Southern District of California. Whatever the issues of this suit, it may be assumed that there exists a dispute between the parties which has necessitated litigation. Accordingly, this Court should not be expected to decide the amount of the indebtedness, if any, owed by Treasure Company to The Adamant Company, Scoville, or their assigns, when the amount was not at issue between the parties in the distribution proceeding below *but is at issue between The Adamant Company, Scoville and Treasure Company in a collateral action not before this Court.*

The "Haywards" also allege error in the denial to them of an equitable lien on the share of the award now assigned to RFC to secure to them "specific payments which became due" from Treasure Company from its operation of Treasure Well prior to the date of seizure. The exact amount of the alleged "specific payments which became due" is not stated, but this Court is requested by them to remand the cause to the District Court with instructions to charge the share of the award now assigned to RFC for an amount which the District Court is to determine.

This request by the "Haywards" involves the consideration of several legal questions to which we respectfully direct the attention of this Court:

Under What Circumstances Does the Right to an Equitable Lien Arise?

It is clear that the right to an equitable lien must arise in one of three ways: (a) where an express contract shows an intention to charge some particular property with a debt or obligation; (b) where the conduct of a party, in the absence of contractual intention, is such that a court of equity will impress a lien upon his property in favor of one whom he has wronged when the circumstances of their dealing prompts the court to order that done which should have been done; and (c) where, by express assignment or otherwise, a transaction resolves itself into a security arrangement so that, in the absence of an adequate remedy at law, assistance of a court of equity is required in the enforcement of the lien.

It is stated in 37 C. J. 315:

> "An equitable lien either arises out of an antecedent and underlying contract, which deals with some specific property, or it arises by implication from the conduct and dealings of the parties, the right or charge being completed by equity, in pursuance of the maxim that equity looks upon things agreed to be done as actually performed. This doctrine, however, is not a limitless remedy to be applied according to the measure of the conscience of the particular chancellor; and where there is no contract out of which the lien could grow, nor any duty on one party to give to the other any charge or lien whatever, no basis for such a lien exists."

Similarly, it is stated in 33 Am. Jur. 427:

> "An equitable lien is a right, not recognized at law, to have a fund or specific property, or its proceeds, applied in whole or in part to the payment of a particular debt or class of debts. It is not an estate or property in the thing itself, nor is it a right to recover the thing, that is, it is not a right which may be the basis of a possessory action, but it is merely a charge upon it. Such a lien may be created by an express contract which shows an intention to charge some particular property with a debt or obligation, or it may arise by implication from the relations and dealings of the parties whose interests are involved. Likewise, a lien may be created by an equitable assignment of a contract, debt, or fund. In fact, if a transaction resolves itself into a security, whatever may be its form and whatever name the parties may choose to give it, it is in equity a lien."

Is There an Express Contract Before This Court Which Reflects an Intention on the Part of Treasure Company to Have Created a Lien Upon Its Leasehold Estate in Favor of Parties to Whom It Assigned Participating Royalty Interests?

The "Haywards," in their opening brief, cite two cases,[1] in each of which an equitable lien was recognized because of the existence of an agreement to pay a specific sum out of the income from certain property. The burden of their argument, however, is not based upon the precise holdings of these two cases. It rests instead upon the proposition that, in California, the holder of a royalty

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[1]*Legard v. Hodges,* 1 Ves. Jun. 477, 29 English Reports Chancery 684; and *Phillips Petroleum Co. v. Gable,* 128 F. 2d 943 (1942).

interest in an oil and gas lease which is created out of the lessee's estate has the same position as a beneficiary of a trust to whom the lessee, as trustee, owes a fiduciary duty. Under this reasoning it is to be supposed that the execution of an assignment of a royalty interest by the lessee constitutes a declaration of trust under the terms of which the lessee holds the leasehold estate for the use and benefit of the royalty holder.

There is no California holding for this proposition and the "Haywards" do not attempt to cite any. Nevertheless, they request this Court to give its approval to the proposition as an *extension* of the California law. Thus, they assert that *there would seem to be no reason why* the holding of the venerable English decision should not be applied to the case at bar, and they suggest that this Court should *not stop* at the point where the California courts have now stopped in defining the extent of their interests *"but should go further and give them complete relief."* They do not argue that the lessee, Treasure Company, in executing assignments to the holders of the royalty interests *intended* to become a trustee for their benefit; they argue instead that "the lessee, *in effect,* agreed to hold the lease in trust for the assignees."

The argument of the "Haywards" is unconcerned with the distinctions between a legal interest and an equitable estate. On the one hand they admit that the interest which they own in the two 1% participating royalties is, under the California law, a legal interest. On the other hand, they argue that Treasure Company is their trustee which presupposes that Treasure Company holds the full legal title and that they hold an equitable estate. This apparent dilemma presents no road-block to their argu-

ment, however, because a single paragraph[2] in their brief suggests that the Federal Court in this proceeding should, as a court of equity, *go further* by impressing an equitable lien than the State courts have gone in holding that they have a legal interest but also suggests that the State Courts have already *gone further* than the equitable relief which they seek by giving them a legal interest.

A careful scrutiny of the California authorities will reveal at the outset that the *Schiffman* case[3] which is cited by the "Haywards" as the leading case for the proposition that owners of participating royalties in an oil and gas lease have a property interest in the lease does not so hold.[4]

The leading California case which defines the rights of owners of participating royalties in oil and gas leases is *La Laguna Ranch Co. v. Dodge, et al.,* 18 Cal. 2d 107, 114 P. 2d 351 (1941), which the Supreme Court decided four years after the *Schiffman* case. Here the plaintiff as owner in fee, brought an action to quiet title against

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[2]Haywards' opening appellants' brief at page 30.

[3]*Schiffman v. Richfield Oil Co.,* 8 Cal. 2d 211, 64 P. 2d 1081 (1937).

[4]The opinion in the *Schiffman* case states three separate times that the decision is not based upon the theory that the royalty holder owns an interest in real property. The opinion states, in part (64 P. 2d 1088): "We are of the view that whether or not the royalty assignments in this case transferred to the holders thereof an interest in the leasehold, *i. e.,* in the *profit a prendre* to produce oil, in any event they vested in the holders a right to share in the proceeds of oil produced during the continuance of the lease by an assignee of the lease with notice. We prefer to base our decision on this ground without determining the question of interest in the leasehold estate as such . . . In the discussion which follows *it may be assumed for purposes of this decision that plaintiff does not have an interest in the leasehold* estate as such." (Emphasis added.)

the defendants who held fractional interests in the production of oil and gas under assignments from parties who had leased the property from the plaintiff. The question before the Court was "does the interest of the holder of a fractional share in the production of oil, which is created out of the estate of the operating lessee, survive after the lessee's voluntary surrender of the leasehold by a quit claim deed?" The trial court's decree quieting title in favor of the plaintiff was affirmed and the opinion of the Supreme Court holds as follows:

1. The defendants held an interest in real property but they did not hold as tenants in common with the lessee.
2. The defendants did not hold an "unlimited" interest but did hold a "determinable interest—a speculative interest in real property which they intended should be determinable by the lessees."
3. The defendants did not acquire from the lessee a portion of the *profit a prendre* or a portion of the leasehold.
4. The quitclaim deeds executed without fraud by the lessees in favor of the lessor operated to terminate the interest of the defendants.

Nowhere in the *La Laguna* opinion is there any suggestion that when the lessees assigned to the defendants fractional interests in the oil and gas production from the lease, the lessees agreed, in effect, to become trustees for the assignees. Certainly this holding, which remains the law of California, would not have been reached if the highest court of the state had construed the execution of the assignments by the lessees to have created a trust relationship because it is elementary that a trustee will

not be permitted to voluntarily convey away the corpus of the trust estate, even if he acts with an abundance of good faith. It is one thing to enjoy the rights of a *cestui que* trust, including the right to trace the assets of the trust, and quite another thing to own a "determinable" interest in real property which is subject to destruction upon the happening of a condition subsequent.

No attempt is made by RFC to define the rights of The Adamant Company and Scoville under their agreement with Treasure Company dated April 5, 1938 [Adamant, Scoville, Wynn, Ex. "D," R. 202, 1272]. Apparently this agreement contemplated a joint ownership, *operation and control* of several leasehold estates by the parties and the sharing of profits and losses therefrom and it is possible that under its terms a "joint adventure" was established. Be that as it may, this agreement is not before this Court for the reason that it was terminated under the express provisions of paragraph III of the Vickers' Judgment, *supra,* and the District Court so concluded [Concl. IV, R. 151-152]. Such rights as The Adamant Company and Scoville may have enjoyed in the joint operation and control of Treasure Well were lost to them as of January 31, 1939, under the express provisions of paragraphs I and IV of the Vickers' Judgment, *supra,* and, accordingly, any reference in the Vickers' Findings of Fact to a "joint adventure" was addressed to the relationship between the parties which existed prior to that date. At all times thereafter, the respective interests of The Adamant Company and Scoville were royalty inter-

ests which, under the law of California, are described as "over-riding royalties," even though created out of the lessee's estate.[5]

It is submitted, therefore, that the facts of this case present no express contract showing the *intention* of Treasure Company to charge its property with any debt or obligation either as trustee or otherwise.

Is There, in This Case, a Showing of Such Improper or Fraudulent Conduct on the Part of Treasure Company Towards the Holders of the Royalty Interests as to Induce a Court of Equity to Impress an Equitable Lien on Treasure Company's Share of the Award Now Assigned to RFC?

It is conceded that if Treasure Company has acted so unconscionably as to appropriate the property of the royalty holders, such property, or its proceeds, in the hands of Treasure Company, or in the hands of its successor in interest, should be impressed with an equitable lien, not on the grounds of a resulting trust but on the grounds of a constructive trust.

The record in this case however, discloses no evidence of any sort on which this Court can base a judgment that Treasure Company should be charged with the duties of a constructive trustee. There are self-serving statements in the briefs filed by the royalty holders that Treasure

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[5]In the *La Laguna* case, *supra,* the Court states: "The term 'over-riding royalty' is applied generally in the industry to such fractional interests in the production of oil and gas as are created from the lessee's estate. This is true whether the over-riding royalty is created by reservation when the original lessee transfers his interest by a sub-lease or whether it is created by grant when the original lessee conveys a fractional share to a third person, as in the instant case."

Company has refused to pay its debts to them but there is not before this Court any proof that Treasure Company does, in effect, owe any debt to them at all.

The alleged debts arose prior to the condemnation seizure and the only evidence which is before this Court as to the conduct of Treasure Company towards the royalty holders prior to the Government's seizure consists of the Findings of Fact and Conclusions of Law of the Los Angeles County Superior Court which support the Vickers' Judgment, *supra*. Among other things, Judge Vickers there found that the defendant, Treasure Company, did not, as alleged in the complaint, convert all or any part of the leasehold property to its own use to the exclusion of any of the plaintiff royalty holders [Vickers' Finding VI, R. 202, 1273]; that when the defendant, Treasure Company, took over the management of Treasure Well, it was operated on its behalf in a good and workmanlike manner and in accordance with good oil field practice, and that none of the plaintiff royalty holders suffered any loss, damage or injury because of said management [Vickers' Finding XVII, R. 202, 1273]; and that as of December 31, 1939, nothing was due or owing by the defendant Treasure Company to any of the plaintiff royalty holders [Vickers' Concl. VIII, R. 202, 1273].

It should be emphasized that the appellants who herein seek an equitable lien do not contend that the particular fund on which they seek the lien was appropriated by Treasure Company from their property. They seek equitable relief merely as alleged unpaid creditors and there-

fore bring to this Court a dispute which is entirely extraneous to the condemnation proceeding. In other words, they would have this Court instruct the District Court in the distribution proceeding to review their course of dealing with Treasure Company prior to the Government's seizure to determine whether any indebtedness is in fact owing to them by Treasure Company, and if so, to grant equitable relief on the theory that Treasure Company is a constructive trustee of its own property for their use and benefit as its creditors.

As above pointed out, The Adamant Company and Scoville have already commenced an accounting action against Treasure Company, which is now at issue in another court, but even if this action were not pending we submit that this Court should question the propriety of a District Court adjudicating in its order of distribution disputes between the claimants to a condemnation award where the disputes are extraneous to the issue of determining those whose property interests have been seized and for which compensation is payable. In *Florida Beaches, et al. v. Niagara Investment Co., et al.,* 148 F. 2d 963 (1945), the Court of Appeals for the Fifth Circuit even adopted this view where the facts indicated that equitable relief was justified and where the collateral dispute was not altogether extraneous to the condemnation proceedings. A foreclosure sale for unpaid taxes had been confirmed to the grantor of Niagara Investment Co. and the prior legal mortgage of Florida Beaches, a corporation, was thereby extinguished. The mortgagee had a right of redemption which was allowed to expire because of an asserted con-

tract between it and the purchaser at the tax sale under the terms of which Florida Beaches purported to enjoy the right to buy the condemned land, designated as Tract 15B, together with other lands which had not been condemned. Niagara Investment Co. claimed the condemnation award but the fund was also claimed by Florida Beaches by reason of its alleged contractual rights which were in default. The Court of Appeals affirmed the District Court's order distributing the fund to Niagara Investment Co., which held the legal title at the time of condemnation, without prejudice to the assertion by Florida Beaches of its rights in a pending equitable proceeding between the parties in the state courts. The Circuit Court of Appeals said at page 964 of 148 F. 2d:

> "If Florida Beaches, or those who represent it, had a valid contract to acquire title, or under the circumstances had an equity to redeem from the sale, it involves the other tracts along with this one, for a lump sum, and needs the aid of a court of equity for its establishment and enforcement. The relief would relate not simply to Tract 15B, but to the entire contract. We do not doubt that in distributing the funds in a condemnation proceeding the District Court can recognize not only the legal title, but also plain equities in the property condemned, but we think it is going too far for it to undertake specific performance of a contract and an adjustment of equities about other lands also, between corporations of the same state over whose controversy it did not have original jurisdiction. The most it ought to do would be to keep the fund safe, if that is shown to

be necessary, until the parties can protect their rights in it elsewhere. It appears in this record that there are already pending in a state court equitable proceedings between these parties where this can be done."

Do the Circumstances in This Case Resolve Themselves Into a Security Transaction Between Treasure Company and the Royalty Holders Giving Rise to a Lien in Favor of the Royalty Holders Which a Court of Equity Will Recognize and Enforce?

This question must be answered in the negative. None of the appellants who seek an equitable lien on the portion of the award now assigned to RFC have contended that Treasure Company has created an equitable mortgage in their favor on its leasehold estate, and it is obvious that the assignments by Treasure Company of fractional shares in the production from Treasure Well was, in no sense of the word, a security transaction. In this connection it should be noted, in passing, that the "Haywards" have admitted that their funds were advanced by them as "investors" for the repayment of which there was "no personal obligation whatever of anyone."[6]

On the basis of the foregoing analysis, we respectfully request this Court to affirm the District Court's holding that no equitable lien should be impressed upon that portion of the condemnation award which is now assigned to RFC.

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[6]Page 32 of opening appellants' brief of "Haywards."

There Is No Merit to the Contention That the Jury Award Was Based Upon Eighty and Six Tenths 1% Working Interest in the Leasehold Upon Which Treasure Well Was Drilled Entitling the Royalty Holders to Have the Award so Distributed That for Each 1% Participating Interest They Will Respectively Receive $\frac{1}{80.6}$ of $194,500.00.

The District Court in its order of distribution awarded to the holders of each 1% participating interest an amount equal to $\frac{1}{100}$ of the net balance of the award [Paragraph II of Judgment, R. 155]. Whereas, RFC has alleged error in the District Court's holding that the total award stands for the lessee's interest in the Fletcher Lease alone,[7] the District Court, in our opinion, was correct in construing each 1% participating royalty interest to be $\frac{1}{100}$ of the total sum in which the participating royalty holders were entitled to share.

The Adamant Company, Scoville, Seeple and Wynn, as well as the "Haywards," allege error in the refusal of the Court to divide the award into 80.6 parts.

The basic fallacy in their contention is evidenced both in the statement of The Adamant Company, Scoville, Seeple and Wynn that "The jury award covered only 80.6% of the leasehold"[8] and in the "Haywards'" reference to

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[7]Pages 24-29 of the opening appellant's brief of RFC.

[8]Page 21 of the opening appellants' brief of The Adamant Company, Scoville, Seeple and Wynn.

"the money which was awarded for the 80.6% working interest."[9]

As we have previously emphasized,[10] the term "total working interest" in Treasure Well was defined with particularity by witnesses in the valuation trial as the *anticipated net profit* to the lessee which would have been derived (in the absence of condemnation) in working Treasure Well during its life expectancy, taking into consideration the potential production, the estimated operating expenses, and the burden of the landowners' royalties [R. 307-310, 332-333, 343]. Whatever the meaning of this term in the oil industry generally, the jury in the valuation trial understood the term to mean a valuation in dollars by which they were to measure the fair market value of the entire leasehold estate.

We repeat that the Government did not seize in condemnation the lessee's anticipatory profits as such. The Government condemned land, including a leasehold interest in the land, and although the concept of "total working interest" was used as a yardstick to determine the value of the leasehold estate, certainly it does not follow that the yardstick was itself condemned.

The jury's verdict places a valuation of $194,500.00 upon the "total working interest in Treasure Company Well No. 8" by which the jury intended to assess the fair market value of the entire leasehold estate. If the word "total" means anything when expressed in terms of arithmetic percentages, it means 100%. The figure 80.6% is

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[9]Page 39 of the opening appellants' brief of "Haywards."

[10]Page 29 of opening appellant's brief of RFC.

by its very nature part of the total 100% and it is quite meaningless to argue, as do some of the royalty holders,[11] that the jury award should be divided "among the total working interests of eighty working interests and six tenths and not among '100 working interests'—which *latter never existed.*"

Assuming, for purposes of the argument, however, that no more than 80.6% of the "working interest" of Treasure Well was owned in the aggregate by all of the appellants before this Court, the remaining 19.4% of the "working interest" must, of necessity, have been owned by someone. Who else could have owned the remaining 19.4%? There are no other parties to be considered except the landlords. Can it be argued that the landlords owned the remaining 19.4%? This conclusion is not tenable because the landlords, although entitled to a 19.4% royalty on the gross production of the well, did not share in any way in the *net* profits of the leasehold.

Fortunately, the record discloses that the jury fully understood that a landlord's right to oil royalties was a matter separate and distinct from what the witnesses called a "working interest." After the jury had commenced its deliberations, it requested further instructions from the Court on this very point and reappeared before Judge Beaumont. The foreman of the jury requested the assistance of the Court in reviewing the evidence which

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[11]Page 27 of opening appellants' brief of Adamant Company Scoville, Seeple and Wynn.

had been presented with respect to the valuation of the "working interest" in Burns' subleases 2 and 3 to Treasure Company,[12] designated in the form of verdict as "Parcel S" [R. 1169].

Judge Beaumont thereupon read to the jury from the transcript of the valuation trial the testimony of the witness, Dodge, who had expressed an opinion that whereas the landowners' royalties under the Burns' subleases 2 and 3 were valuable, there was, in his opinion, no value to the "working interest" in the two leases [R. 1180-1181]. In particular, Judge Beaumont read to the jury the explanation which the witness, Dodge, gave:

> "Assuming a well like Vidor 18 was drilled, the Union Oil Company drilled that well, put up the money and they lost money, but they had to pay their royalty to the owner of the Vidor lease, without regard to whether the well was economical or not, *so it might be an instance where a landowner's royalty might possibly have value where a working interest would have no value.*" (Emphasis added.)

If the concept of "working interest," as thus explained, precludes by definition the interest of the landlords and if there are no other parties in interest except the operating lessee and its assignees, it necessarily follows that the "total working interest" was intended by the jury to represent the full 100% interest in the leasehold estate.

It should not be overlooked that the valuation trial was an *in rem* proceeding. It was concerned solely with the

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[12]It was necessary to establish the market value of these leaseholds because the appellant, Wynn, claimed an interest in them under assignments from Treasure Company. No other interest in the leaseholds existed except that of Treasure Company and its claim was relinquished in a settlement made out of court.

valuation of various parcels of property and the rights of the respective claimants to such property were not considered by the jury. Not until the valuation judgment had been entered and the award deposited in the registry of the Court did the issue arise as to whom the party claimants are and the amount of their distributive shares.

In legal contemplation, there is no basis for the assumption that a 1% participating royalty interest in the leasehold, which the Court was called upon to evaluate in the distribution proceeding, is equivalent to any particular percentage of the "total working interest" as understood in the valuation trial. Any connection between a participating royalty interest and a percentage of the "total working interest" is without legal foundation and is fictitious. The one is a property right entitling the holder to share in the net *actual* production of a leasehold. The other, at least for purposes of this case, is a pure abstraction, involving a *conjectural* production for a probable period based upon nothing more than informed guesses of experts.

Suppose, for example, there had been no valuation trial. Suppose the Government had not only settled with the landlords out of court but had also reached an amicable lump sum joint settlement with the lessee and its royalty holders and, with their consent, had deposited the sum with a stake-holder until its distribution could be agreed upon. If a dispute then arose among the claimants as to how the fund should be divided and the matter were litigated—the court would not be concerned with the value of the oil which would have been produced or with the amount of operating expenses which would have been incurred. Even if the lease, in the opinion of experts,

were capable of no further production, the parties litigant could be expected to assert their rights to the fund on the basis of their percentage ownership in the leasehold and not in the unproduced oil.

This suppositious case is analogous to the case at bar. There was no amicable settlement but there was a lump sum settlement by operation of law in a proceeding which took no cognizance of individual claims to the property. How the award was computed is irrelevant to the present dispute so long as the fund stands, as it does, for the aggregate of all of the rights of the claimants.

We, accordingly, request this court to settle the dispute which has arisen on the sound legal basis that a leasehold estate has been destroyed, that its fair market value on the date of seizure is now represented by a fund, and that the fund must be divided as though there were a verdict reading "For the entire leasehold estate of the Fletcher Lease and the Burns No. 1 Lease—$194,500.00."

There Is Merit to the Contention of the "Haywards" That Their Share of the Award Should Not Be Measured by the Net Balance of $191,700.00 but Should Be Measured by the Total Award of $194,500.00.

RFC concedes that inasmuch as the "Haywards" did not join in the stipulation upon which the District Judge awarded the sum of $2,800.00 as an expense of Mastership in a collateral accounting case brought by The Adamant Company and Walter B. Scoville against Treasure Company, no part of such expense should be borne by the "Haywards."

Conclusion.

For the reasons set forth above, this Honorable Court should deny the specifications of error asserted by the appellants, The Adamant Company, Walter B. Scoville, Joe Seeple and Harry Wynn, and the specifications of error asserted by the appellants "Haywards," except with respect to their contention concerning their liability for a portion of the Mastership fees, and should reverse the judgment of distribution of the Honorable Harry C. Westover entered on October 30, 1950, with instructions to make appropriate findings and to enter judgment in accordance with the prayer of the Reconstruction Finance Corporation, assignee of Treasure Company, as appellant.

Respectfully submitted,

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